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SUBJECT: BROWN'S ECONOMIC PRIORITIES AND CHALLENGES

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    1B. B) LONDON 1291  
    1C. C) LONDON 1763

Classified By: E/MIN Sandra E. Clark for Reasons 1.4 (b) and (d)

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SUMMARY AND COMMENT  
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11. (C) Gordon Brown is the longest continuously serving Chancellor of the Exchequer since 1823. During his ten year reign, Brown has enjoyed tremendous authority and autonomy in managing the UK's economy. As a result, Brown is expected to continue the economic and financial policies he developed as Chancellor when he becomes Prime Minister by the end of June. Over his tenure, Brown has been able to refine his vision for the UK government's role in the economy. After some tinkering, each of Brown's last four budgets started with the same message: "The Government's economic objective is to build a strong economy and a fair society, where there is opportunity and security for all." Brown recently, and we believe reluctantly (Refs A and B), added caring for the environment as a third government objective. Brown's economic focus will remain on these three pillars: 1) economic growth based on stability (low inflation), 2) social justice driven by improving the quality of and access to education and training, and 3) caring for the environment through international action and domestic incentives. These pillars will also continue to inspire his international economic policies.

12. (C) Despite devoting significant resources and achieving some success, challenges remain to Brown's credibility in each area. Nevertheless, we expect Brown to frame the debate on economic policy in the early days of his leadership by highlighting his three objectives. The economy will remain comfortable ground for Brown to return to as compared with the less-popular aspects of Tony Blair's legacy in Iraq and the Middle East (septel).

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A Stable Macroeconomic Foundation  
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13. (C) Gordon Brown is passionate about the social goals at the heart of the Labour Party. His commitment to economic stability stems from the belief that without a firm macroeconomic foundation (low inflation, low interest rates, low unemployment, and solid growth), the government would not have the time or resources to devote to solving Britain's social ills. His 2007 budget states that the government's "long-term economic goal is to maintain macroeconomic stability, ensuring the fiscal rules are met at all times and that inflation remains low." He frequently compares the last ten years under his leadership with the old British "stop-go" economy of the 1980s and early 1990s. The recent "longest period of unbroken growth and stability in (UK) history" actually started about four years before Brown assumed

responsibility for the economy. In addition, he has benefited from a remarkably stable global economy. However, most analysts agree that Brown improved conditions when he granted the Bank of England independence in 1997, consolidated regulators for financial services and telecommunications, and installed reasonable, if not firm, fiscal rules. Another key move was Brown's decision to embrace London's financial sector. In June 2006, Brown wrote a comment in the Financial Times claiming, "Our economic leadership abroad and our stability at home depend on our continuing to have the strength to take the right long-term decisions and to put stability first. That is the test by which I want to be judged."

¶4. (C) Brown's record for running the British economy is his strongest asset. Nevertheless, criticisms remain. Despite the impressive performance of the overall economy, the outlook for public finances has deteriorated recently. In his most recent budget, Brown controversially ended the current economic cycle (starting in 1997-98) in 2006-07 in order to meet his own "golden rule" of balancing the current (non-capital) budget over the entire economic cycle, rather than risk missing this target with future deficits. This redefinition will make it more difficult for Brown as Prime Minister to justify reducing taxes or further increasing spending on public services in the next economic cycle. Brown has earned a reputation for introducing "stealth" taxes by cutting some tax breaks, raising marginal tax rates, and creating new tax schemes in order to maintain high levels of spending while lowering the headline personal and corporate tax levels. Although efforts are underway to reduce the administrative costs of doing business and to expand the risk based approach to regulation adopted by the Financial Services Authority more

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broadly, critics claim that bureaucratic requirements have increased, rather than declined, under Brown. Some traditionally British companies have moved their headquarters abroad to avoid paying UK taxes. He is under pressure from public sector unions for capping pay increases in an attempt to increase the proportion of spending that goes to front-line services. Most recently, his stewardship of the overall economy has come under scrutiny for the first time as the March inflation rate reached 3.1 percent, the highest rate since Bank of England independence (Note: the inflation rate fell back down to 2.8 percent in April).

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#### ----- Britain's Answer to Globalization: Education and Skills -----

¶5. (C) Brown concluded his December 2006 pre-budget speech to the House of Commons stating "Stability (is) our foundation. Education our number one priority." Regarding globalization, Brown takes as a given an open investment climate for the UK and will continue to advocate for a freer trade environment to benefit the UK economy and the developing world (Ref B). During his tenure as Chancellor, Brown has promoted new skills, entrepreneurship and innovation as ways for Britain to meet the challenges of globalization. Brown is fond of the "American entrepreneur spirit" and has often used his meetings with U.S. Secretaries of the Treasury to encourage more enterprise and innovation in the UK. In November 2003, Chancellor Brown and former Treasury Secretary John Snow launched a "U.S.-UK Initiative on Productivity" aimed at spurring entrepreneurial links between U.S. and UK universities in research, technology and management. At the November 2006 CBI national conference attended by Secretary Paulson, Brown argued that "the challenge for Britain is to out perform our competitors, the answer to the jobs lost through offshoring is to upskill, and the answer to outsourcing is to out innovate." More recently, Brown told the Confederation of Indian Industry in Bangalore "the answer to globalization is not protectionism to safeguard the old interests of a few,

but education that opens up opportunity to realize the potential of the many. And so the best economic policy is a good education policy."

¶ 6. (C) When criticized about the size of the fiscal deficit, Brown argues that he could pursue a balanced budget policy but instead chooses to borrow in order to fund investment in education, health, transport and housing. He has increased the capital investment in schools almost six-fold since 1997 and intends to raise the amount of money spent per pupil in public schools to the level spent per pupil in private schools. Few criticize the government's commitment to increasing funding for education and building professional skills in the UK. However, there is much criticism regarding the effectiveness of those funds. The Chancellor is unlikely to meet many of his ambitious targets for spending per pupil, improving test scores, expanding adult education and increasing workforce skills. Despite the increased spending, the UK remains below the OECD average for proportion of qualified adults. In March, the director-general of the British Chambers of Commerce (BCC) said the training system reforms were not making any difference, referring to a BCC survey showing more than half of the 304 employers questioned were finding it more difficult to find skilled staff today than five years ago.

¶ 7. (SBU) In one of his first announcements in his campaign to become the next Labour Party leader and UK Prime Minister, Brown said on May 15 that his priorities for education will focus on the quality of what is taught in the classroom (i.e. education standards), rather than on new school structures. He is expected to announce the launch of an initiative called Every Child Counts that will provide one-to-one tutoring to around 300,000 primary schoolchildren who are struggling with math. The program is expected to cost around GBP 35 million (USD 70 million).

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From Debt Relief and Aid to Empowerment

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¶ 8. (C) Education is not only the answer for Britain, but also the answer for development, according to Brown. Speaking to New York University in December 2005, Brown said, "we should begin 2006 with a new resolution, an urgent timetable for every continent, every country, to offer one of the greatest and most achievable gifts of all in every continent: universal free education for all children - a declaration of our faith in the future." In a March 2006 speech, Brown argued for a new Marshall Plan for developing countries "that has got to be based not on simply debt relief for the poor - that was the issue of the Eighties and Nineties that we've

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had to solve - or on simply aid as compensation for the poor, it's got to be about empowerment for the poor." At a May 2, 2007 conference hosted by the European Commission and World Bank, Brown urged rich countries to live up to the promises made at the 2005 G8 Summit in Gleneagles to increase international aid by USD 50 billion by 2010 to meet UN poverty targets. "We can be the first generation in history to send every child to school. We will work with every country, charities and international organizations to achieve this goal." In 2006, Brown committed Britain to provide at least USD 15 billion over the next ten years to finance education in Africa - four times as much as the USD 3.5 billion of the previous ten years.

¶ 9. (C) With sociojustice through empowerment as the ultimate goal, we still expect Brown to continue to support direct assistance to the poor both within the UK and abroad, in particular in Africa. Domestically, Brown has targeted children by promising to raise the child tax credit from GBP 575 per year in 1997 to GBP 1,040 in 2010. For the poorest child, he raised the tax credit from GBP 1,400 in 1997 to GBP

3,900. Despite his efforts, child poverty remains a stubborn problem in the UK. After years of declines, the number of UK children in relative poverty jumped by 200,000 in 2005, leaving it far from its targets. The UK also placed last among 21 industrialized economies in the most recent UNICEF measure of child well-being. Internationally, Brown has championed debt relief for the poorest countries through the G-8 Multilateral Debt Relief Initiative (MDRI) and borrowing to fund the expensive International Finance Facility for Immunizations (IFFIm). Most recently, Brown has expressed interest in better coordinating the UK's anti-malaria efforts with President Bush's Malaria Initiative (Ref C).

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The Third Pillar: Climate Change  
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¶10. (C) In March 2007, the same month he delivered the 2007 budget to the House of Commons, Brown told the Green Alliance that the UK had to "...go beyond the traditional alliance of economic growth and social justice as the central concerns of policy, and put growth, justice and environmental care together as our trinity of objectives." As previously reported (Refs A and B), Brown was a late convert to the climate change cause and reluctantly dragged into the debate with an eye on the 2009 elections. Despite domestic pressures, his primary focus is on an international solution.

He sees the European Union finding a new and unifying role in protecting the environment and tackling climate change. He plans to use the G8 to urge a resumption of UN negotiations based on the five elements of - "a long-term stabilization goal; emissions trading; technology development and deployment; deforestation; and adaptation." He argues the World Bank, "once a bank only for economic development, must become a bank for the environment as well." And he believes the UN Environment Program should be upgraded into the environmental policy pillar of the UN system.

¶11. (C) Domestically, Brown has been less ambitious. As Chancellor, he tinkered with tax incentives for innovation and conservation. Eyeing London's strong financial services sector, he states his "primary ambition is to build a global carbon market, founded on the EU Emissions Trading Scheme and centered in London." Otherwise, his initiatives have disappointed environmentalists, especially after the momentum created by the Stern Review on the Economics of Climate Change commissioned by Brown in July 2005 and published in October 2006. In December 2006, Brown announced an increase in the air passenger duty as an environmental initiative. In reality, the money flows into the general coffers and can be spent however Brown chooses. Opposition leader David Cameron will no doubt continue to challenge Brown's credibility for failing to take stronger action against climate change while serving as one of the most powerful Chancellor's in Britain's history. See our upcoming cable for more detail on Brown's position on this topic.

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